Fiscal and Debt Management Assessment

Project Number: 52230
April 2020

PRC: Xiangtan Low-Carbon Transformation Sector Development Program

CURRENCY EQUIVALENTS
(as of 6 April 2020)

Currency unit	–	yuan (CNY)
CNY1.00	=	$0.1410
$1.00	=	CNY 7.0916

ABBREVIATIONS

ADB	–	Asian Development Bank
GDP	–	gross domestic product
GFB	–	government fund budget
HPG	–	Hunan Provincial Government
PFB	–	public finance budget
XMG	–	Xiangtan Municipal Government

NOTE

In this report, "$" refers to US dollars.

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I. INTRODUCTION

1. This Assessment summarizes policy dialogue and information exchanges held between the Asian Development Bank (ADB) experts and Xiangtan Municipal Government (XMG) officials on July 1-3, September 24-27, November 4-8, and 2019. Meetings included officials from the XMG's Finance Bureau (Budget, Debt Management, Non-tax Revenue, Treasury), Tax Bureau, and Land Reserve Center.

2. The main conclusions of the Assessment are the following:

(i) The XMG exhibits high level of debt, although key debt ratios have been on a declining path since 2018 and a sound regulatory framework is in place to contain debt risks and encourage de-leveraging.

(ii) The People's Republic of China (PRC) Government regulations make a clear distinction between 'government debt' (which is legally recognized as a liability to be repaid out of budget resources) and 'hidden debt' (which is not legally recognized as a financial obligation of the government). Established ceilings on government debt ratios and numerous regulations issued by the Central Government provide a robust framework for monitoring, managing, and mitigating debt risks.

(iii) The Hunan Provincial Government (HPG) has issued numerous regulations on sub-provincial government debt. It has established a Risk Classification and an Early Warning System that constrain quotas of sub-provincial bond issuances and thus facilitate de-leveraging. Xiangtan Government must comply with these regulations as well.

(iv) The HPG has issued directives obliging sub-provincial governments to rationalize expenditures (and even eliminate selected expenses) if their debt risks are classified in higher brackets. In addition, it has established limits on the growth of entities typically used to originate 'hidden debt' (namely, special purpose vehicles, public-private partnerships, and government funds). Xiangtan Government must comply with these regulations as well.

(v) The XMG has been taking measures to control budget expenditures and mobilize resources, particularly land use-right leasing revenues. Debt ratios are on a declining path and the debt portfolio carries low interest rates, medium-to-long maturities, and no exposure to currency risk.

(vi) ADB loan to the XMG will be classified as 'government debt' and thus legally recognized to be repaid using budget resources. It will increase the Xiangtan Government's debt stock by only 5% to 6%. It will have *de facto* seniority relative to other liabilities of Xiangtan Government and a sovereign guarantee.

(vii) The XMG's public finances are sustainable in the medium- to long-term, as assessed in a Debt Sustainability Analysis. Projected debt indicators suggest the debt position remains sustainable when the ADB loan is considered, and the debt-service obligations continue to be affordable.

II. CONTEXT AND RECENT SOCIOECONOMIC DEVELOPMENTS IN THE PRC

3. The PRC, into the upper middle-income phase since 2010, will be expected to become a high-income country over the next decade. The PRC's economic transformation over the past four decades has promoted the rapid socioeconomic development with the tremendous size of economies and better standards of human living. The PRC's real per capita Gross National Income (GNI) has increased almost 3 times over the late decade (from $ 3,680 in 2009 to $ 9,470

in 2018) and over 850 million people have lifted themselves out of poverty. From 2013 to 2018, more than 12 million people per year on average have been lifted out of poverty steadily, contributing up to 70% of global poverty reduction. The PRC is the first developing country in the world to achieve the poverty reduction goal of Millennium Development Goals (MDGs) and made a major contribution to the all achievements of the MDGs globally.

4. The PRC's economy has shown a slowdown trend at both national and subnational levels, while it remains high by the international standards. With a population of 1.4 billion, the PRC generated $ 5,879 billion (CNY 41,212 billion) in real gross domestic product (GDP), becoming and upholding the world's second largest economy since 2010. It has contributed around 30% of global growth in the past eight years. For the PRC itself, however, GDP growth rates at both national and subnational levels has shifted from high speed into 'new normal'. The annual growth at national level has moderated from 10.6% to 6.6% in the past decade and it will maintain the slight slowdown trend with a growth target set out at 6%-6.5% for 2019 (Figure 1). Hunan Province, at ranking 8th in economic outputs of 31 provinces in 2018, has shown a decreasing trend but still higher than the national average in GDP growth. The same applies to Xiangtan City, whose GDP growth rate ranked 7th in 14 prefectural cities of Hunan Province in 2018.

5. A series of loose macroeconomic policies were adopted to prevent a sharp slowdown of the national economy in 2018-2019. On the one hand, The People's Bank of China (PBOC) implemented, in fact, looser monetary and credit policies, lowering benchmark interest rates and required reserve ratios. On the other hand, The Ministry of Finance (MoF) adopted the proactive fiscal policies by raising the budget deficit ratio and cutting taxes. This partly reflects accelerated infrastructure investment by the Central Government to offset cutbacks by local governments related to falling land lease revenues and new restrictions on off-budgetary investments. Subnational governments (both provincial and below-province level governments, sub-national goverments [SNGs]) like Hunan Province and Xiangtan City followed the national policies and had the same feedbacks.

6. Xiangtan City takes the leading level of the province in socioeconomic development in terms of per capita GDP and urbanization. Xiangtan City, as one of 14 prefectural-level cities in Hunan Province, is located 40 kilometers (km) south of Hunan's capital---Changsha---with an administrative area of 5.01 thousand square kilometers (km^2). It consists of five counties (county-level cities/districts) under the administrative division, but only two (Yuhu District and Yuetang District) are directly under fiscal supervise of prefectural government. In 2018, its population reached 2.87 million (equivalent to the size of Mongolia), ranking 12th in 14 prefectural cities of Hunan Province (Table 1). Its urbanization rate reached 62.9% , higher than both national and Hunan provincial averages. As a relatively less populous city, Xiangtan's per capita GDP ranked 2nd in Hunan Province with an amount of CNY 75,609 yuan, while its GDP held a middle position (rank 7th) for an amount of CNY 216 billion. Despite the trend of economic slowdown in the last decade, Xiangtan's growth rate has been higher than the national and provincial averages. For now, the number of rural people under the poverty line has decreased to 7,550 with a cumulative poverty reduction of 98,776 people. The poverty incidence has dropped from 5.74% at the end of 2014 to 0.36% at the end of 2018.

Initiatives for Low-Carbon Development

7. **The 13th Five-Year Plan envisages objectives for Low-Carbon Development.** The PRC's 13th Five-Year Plan (2016–2020) addresses these issues as follows. It highlights the development of services and measures to address environmental and social imbalances, setting

targets to reduce pollution, to increase energy efficiency, to improve access to education and healthcare, and to expand social protection. The 13th Five-Year Plan's annual growth target is 6.5%, reflecting the rebalancing of the economy and the focus on the quality of growth while maintaining the objective of achieving a "moderately prosperous society" by 2020 (doubling GDP for 2010-2020). As for the low-carbon transportation and green buildings which are closely related to the proposed Xiangtan Low-Carbon Transformation Sector Development Program (XLCTSDP), the 13th Five-Year Plan put forward the following strategies: (i) the governments at all levels shall promote the wide applications of standardized transportation equipment, energy-saving and environment-friendly transportation vehicles, and modern information technologies; (ii) Urban residents will be guided to go green-commuting by the popularization of green travel service systems such as urban bicycles and public transportation; and (iii) the energy consumption revolution will be extended to the field of construction with the implementation of plans for building energy efficiency improvement and green building industry chain development.

8. **HPG made a five-year strategic plan for Low-Carbon Development in the Province (2016-2020) (HPG's Circular No 32 of 2016).** The plan deployed the specific carbon-reducing measures and expected goals in the following eight aspects including industrial system, energy structure, low-carbon transportation, low-carbon building, carbon sink development, low-carbon technical support, resource utilization, and low-carbon consumption. Among these, the expected goals of three aspects are directly related to XLCTSDP. Firstly, the urban residents will be guided to go green commuting by the promotion and popularization of green public transportation vehicles. By 2020, the proportion of new energy vehicles in the newly added and replaced buses will reach 65%, and 14 prefectural cities will take the lead in building an urban slow traffic system like public bicycle transportation. Secondly, the intelligent transportation will be promoted by the application of modern information technologies in the field of transportation. By 2020, the traffic operation monitoring network is more comprehensive and efficient, with 100% access rate of satellite navigation system for key operating vehicles. Thirdly, low-carbon buildings will be promoted by the energy-saving renovation of existing buildings and the energy-saving management of new buildings. By 2020, the proportion of green ones in new buildings in the province will reach 100% and 65% energy-saving standards will be fully implemented for new buildings.

III. THE PRC'S SUBNATIONAL FISCAL FRAMEWORK AND INTER-GOVERNMENTAL FISCAL Relationships

9. **The PRC's Province-Fiscally-Managing-County (PFMC) reform, initiating in 2002, de-layered fiscal governance in the provinces by allowing direct flow of fiscal funds from the province to counties and in the process by-passing the prefecture-level governments.** Enhanced focuses on releasing county fiscal constraints and promoting county economy led the Chinese authorities to have a second look at its originally hierarchical 5-tier layer cake governance structure. Most of provinces including Hunan has adopted the PFMC reform by abolishing prefecture as an intermediate fiscal tier between province and county. For now, the HPG directly manages and supervises the public finance and debt management of all 14 prefectural cities and 79 counties and county-level cities.[1]

[1] By the end of 2018, Hunan Province consisted of 14 prefectures which were followed by 122 county-level divisions including 17 county-level cities, 62 counties, 7 autonomous counties, and 36 districts. According to the HPG's circular No 3 of 2010 (*Xiangfa [2010] No. 3*), 79 counties and county-level cities were directly managed and supervised by the provincial government in the fiscal system.

10. **The PRC's two government budgets of general public finance and government funds provide major financial supports for the public service supply, public infrastructure construction, and government debt repayment.** The PRC's government budgets are reflected in four categories of budget books including general public finance, government funds, state-owned capital operation, and social insurance funds. These four budgets remain their own integrity and mutual independent while the last three budgets are linked up respectively with the general public budget for the consolidated planning and use of government budgets. The surplus funds from government funds and state-owned capital operation can be transferred into the general public budget in order to improve the use efficiency of government budgets. The general public budget, as the most important and largest one in four budget books, consists of taxes, non-taxes, debts, and transfers. It is used mainly for the public service supply and the only source of repayments on general government debts. The government fund budget comes mostly from the land-leasing revenue and is used for the specific purposes of infrastructure construction and special government debt repayments.

11. **The PRC's public finance framework is characterized by a dual assignment system of centralized revenue sources and decentralized expenditure responsibilities.** In the past decade, nearly a half of public revenues pass through the central government budget, while over 85 percent of public expenditures are made at subnational level.[2] Under the context of balanced budget principle, the huge vertical fiscal gap—between revenue and expenditure—for the operating budget of SNGs is mostly covered by the central government via fiscal transfers including tax rebates, general-purpose and special-purpose transfers. In addition, SNGs provide public services and infrastructure investment through borrowing and land-leasing revenues. Especially since 2015, the new Budget Law explicitly allows for SNG borrowing, while restricting the former off-budgetary schemes for investment finance. Local bonds have become the only legal way for SNGs themselves to borrow money.

12. **The PRC has developed a guideline and roadmap for further delineating inter-governmental functionalities and expenditure responsibilities since 2016.** According to the State Council's circular No 49 of 2016, The delineation of functionalities between the central and SNGs shall be completed by 2020. Government functionalities are classified into three categories: central functions, subnational functions, and central-subnational shared functions (Table 2). The main principle is that the central government should directly provide public services that affect market integration and those with strong externalities, such as national defense. SNGs should provide functions whose benefits are largely confined to their respective jurisdictions, such as municipal transportation and rural roads. Responsibility for functions that have both national and localized benefits should be shared.

13. **This clarification of the division of functions is expected to increase the** predictability **of the mandates imposed on SNGs and the share of financing borne by the central government.** The central government and SNGs finance their respective functionalities and share the finance for the shared functionalities. Functions in which there is a predominant national interest, such as basic old-age insurance, compulsory education, and primary health, would be largely financed by the central government based on nationally unified standards.

14. **Tax-sharing arrangements between the PRC Government and SNGs are stable and are governed by State Council Decrees (No 85, 1993 and No. 37, 2001).** Tax revenues are shared between 5 layers of governments while all authorities of tax bases, tax rates and tax

[2] Data source: China's National Statistics Bureau.

legislation are determined generally by the central government. Only for few categories of local taxes like resources tax and environmental tax, local governments are granted to set their tax rates within the boundary set by the central government since 2017. Taxes are collected by the National Tax Administration to the National Single Treasury Account and disbursed to the Provinces. Provinces then decide the tax-sharing arrangements between the Provincial Government and their city/county governments within their jurisdiction. Table 3 lists the tax sharing arrangements between the central government, the HPG and the XMG.

15. **Intergovernmental transfers are mostly rule-based, and adequately cover the gap between revenues and recurrent expenditures. Intergovernmental transfers consist of tax rebates, general-purpose and specific-purpose transfers, financing nearly two-thirds of local expenditure.** In 2018, the central government granted the fiscal transfers of total CNY6,968 billion to SNGs through the layer-cake governance structure, in which 55.6 % of transfers are provided as general-purpose transfers in an unconditional manner, with the rest transferred as tax rebates (11.5%) or for specific purposes (32.9%). For the tax rebates, SNGs obtained CNY 712 billion rebates on two major taxes (VAT and Consumption taxes), contributing 10.3% of total central-local transfers. General-purpose transfers are mainly for equalization purposes and fill the financing gap between standard revenues and standard expenditures. In which, equalization transfers from the central to SNGs were CNY2,444 billion, accounting for 35.1 of total transfers. Specific-purpose transfers, granted by various line agencies, protect the funding for the Central Government's priority programs, mostly in infrastructure, agriculture production development, environmental protection, etc.[3]

16. **Policies of tax and administrative fee reduction (TAFR) has a negative impact on local revenue, while releasing tax burdens on market entities and promoting the optimization of economic structure.** The Value-Added Tax (VAT) reform, as a "main course" of TAFR policies, was initiated in 2012 and put into the full implementation in 2016. On one hand, it has narrowed down the resource of local fiscal revenue, by replacing a local "business tax" with a central-local shared tax "value added tax". On the other hand, it caused the decrease in the overall size of national fiscal revenue by reducing the tax rates of VAT four times since 2016. In addition, a series of reduction in other taxes (like tax rates of individual income tax) and administrative fees (like provincial administrative fees on enterprise and rates of pension and unemployment insurances) further weakened the local public finance. In last three years, PRC's tax revenues nationwide were reduced by CNY 573.6 billion n in 2016, CNY 918.6 billion in 2017, and CNY 1,300 billion in 2018. This number in 2019 will be expected to reach over CNY 2,000 billion.

17. **The central government has issued a series of remedial measures to compensate SNGs for this shrinking change of local revenues caused by the TAFR reform.** Firstly, the share of VAT revenues accruing to SNGs was increased from 25% to 50% and the local share of VAT retained for tax rebate was reduced from 50% to 15% in general.[4] Secondly, the State Council clearly declared in October 2019 that the consumption tax shall be shifted from collection on production process to collection on wholesale and retails process and steadily transferred from

[3] Data Source: China's Final Accounts of General Public Budget Expenditure in 2018.

[4] According to the State Council's Circular No 21 of 2019 (*Guofa [2019] No 21*), the local share of the VAT retained for tax rebate shall be adjusted from 50% to 15%. The remaining 35% shall be temporarily paid by the local government of where the enterprise is located, and then be evenly shared by all levels of subnational governments according to the proportion of the VAT shares of the previous year. The part of the advance paid more than the actual share shall be compensated by transferring from the central to provincial government of where the enterprise is located on a monthly basis.

the central to the local governments. Thirdly, the potential losses caused by the TAFR reform shall be covered by transfers from the Central Government.

18. **The PRC' fiscal reforms, though unfolding, already generated positive results, and made subnational finance more sustainable.** A primary challenge at the subnational level concerns lack of autonomy in taxation and weak capacity to monitor and manage the contingent liabilities emanating from quasi-public activities. Given that SNGs have little control over their revenues and are constrained to realize most current expenditures according to centrally determined norms and regulations, macroeconomic adjustment needs to focus almost entirely on quasi-public investment spending. Provinces can also adjust the share of central transfers passed down to local governments, but within limits dictated by expenditure assignments and central norms. A fundamental problem for long run sustainability at the subnational level going forward is the optimistic projection of revenue stream or under-estimation of cost of the quasi-public projects although they are expected to generate adequate revenues to cover the full cost of the projects. The recently released Government Investment Decree, if being well implemented, should enhance the scrutiny over government investment projects and contain contingent liabilities.

Regulations on Subnational Debt

19. **A number of recent reforms regulate subnational borrowing and debt.** The 2014 reform of the Budget Law, effective as of January 1, 2015, as well as subsequent State Council decisions allow for subnational government bond issuance subject to annual quotas. Only local governments at provincial level shall be allowed to borrow in this manner both for themselves and on behalf of sub-provincial governments. The Golden Rule applies: such borrowing can only be used to finance capital expenditures. The Law also prohibits the Central Government from bailing out SNGs. Quotas for the nation-wide aggregate outstanding subnational debt and net debt financing require the approval of the National Peoples' Congress. Within these aggregate limits, the Ministry of Finance sets a debt ceiling for each province and closely monitors compliance, while provinces set debt ceilings for local governments within the overall limit. In addition, SNGs are authorized to issue bonds to swap legacy off-budget government debts that have now been made the explicit responsibility of SNGs. To access the capital market, provinces must also follow regulations for information disclosure, obtain credit ratings, and follow market rules.

20. **Management of debt risks is well established and guided by policies and directive from the Central Government.** Local government bonds are an important supplement to local fiscal revenue severely affected by the TAFR policies, as a sole legal way for SNGs to raise debts. The PRC has loosened gradually its grip on local authorities of bond issuance with a strictly centralized control over the overall size and annual ceiling of local debts since 2014. According to the source of repayment funds, local government bonds can be divided into general bonds and special bonds, respectively issued for financing public welfare projects without benefits and those with certain benefits. The general bonds shall be repaid by the general public budget revenues, while the special bonds are repaid by the government funds and project profits. It is worth noting that only general bonds shall be accounted into fiscal deficits. In addition, a series of revenue bonds, starting from 2017, have been issued for financing special projects like land reserve, toll road, shantytown renovation, or others. the bonds shall be paid by the corresponding revenue items of government funds or special incomes from the projects. By the first half of 2019, the actual balance of local debts has exceeded CNY 20 trillion. Of which, the general and special debts were CNY 11,840 billion and CNY 8,708 billion respectively in terms of repayment source; the government bond and outstanding non-bond debts were CNY 20,233 billion and CNY 315 billion. Local bonds, especially general bonds, are the major form for local governments to

borrowing and financing the capital expenditure. The potential debt risks cannot be underestimated, although it is still within the debt ceiling approved by the National People's Congress.

21. **Central Government regulations make a clear distinction between 'government debt' and 'hidden debt'.** 'Government debt' is legally recognized as a liability of the borrowing government to be repaid with budget resources, while 'hidden debt' is not legally recognized as a financial obligation of the government. Loans from ADB, for instance, are within the definition of 'government debt' and have seniority relative to other liabilities. Special entities or contracts (e.g., special purpose vehicles, public-private partnerships, government funds) are typically used by subnational governments to take on liabilities deemed as 'hidden debt'.

22. **Centralized control of government borrowing is critical to managing the local debt risks. For now, the PRC controls provincial borrowing in four ways.** Firstly, control via market discipline. This works where the capital market functions reasonably well, credit-rating agencies are reliable and timely, and the government lets the credit market operate freely. The PRC adopted this approach with the creation of the provincial bond market. Current shortcomings include the quality of ratings and volatility in pricing. Secondly, via cooperation among different levels of government. The central government consults with provinces through the budgetary process. The benefit of this approach is that provinces become aware of the fiscal implications of their actions and hopefully improve fiscal discipline. Thirdly, via controls based on administrative rules and/or formal "fiscal responsibility" legislation. This has been the predominant approach in the PRC such as the formula capping provincial borrowing administered by the Ministry of Finance. Fourthly, via direct controls by the central government on permission of local bond issuances, the overall size of local debts, and annual quota of local bonds.

23. **Measures are being introduced to control off-budget borrowing and risk taking.** Local governments should speed up the clean-up of platform companies, complete the task of reducing two-thirds by the end of December 2018, and reach the target in all respects by 2019. The Office of the Leading Group of the Provincial Government Debt Management (often referred to as the Provincial Debt Office) will carry out special checks on this issue, and those failing to meet the standards shall be ordered to rectify within a time limit.

IV. XIANGTAN GOVERNMENT BOUNDARIES PERTINENT FOR THIS ASSESSMENT

24. **This Assessment covers a comprehensive universe of Government agencies in the Xiangtan City.** Xiangtan Prefecture includes four units of administration: the Prefectural Government Agencies (Directly-Managed Units, which comprise all Bureaus and Public Institutions) and three Development Zones (named Gaoxin, Jingkai, and Zhaoshan) (Table 4). For simplicity, this Assessment refers to 'the XMG' to denote the aggregate of Prefectural Government Agencies and the three Development Zones.

25. **Development Zones were created to pursue national development objectives, and their legal and political status differs from counties'.** The special status granted to these Development Zones facilitates raising finance, e.g., the HPG can issue special bonds on behalf of the Zones, as it does on behalf of the XMG. Nevertheless, the Development Zones have limited financial autonomy since their budgets—and especially, the allocation of their revenues—must be prepared together with the XMG's Finance Bureau and approved by the People's Congress of Xiangtan Prefecture. The Zones' budget expenditures and some important revenue sources (e.g.,

transfers received from the land use-right leasing revenue generated by XMG) ultimately depend on decisions made by the Prefectural Government. Their fiscal flows are therefore not autonomous, despite of being accounted and reported as separate budgets. For this reason, their budgets are consolidated with those of the Prefectural Government Agencies for the purpose of this Assessment.

26. The official Xiangtan Consolidated Budget, published in the XMG Budget Report, includes a broader Government boundary: the Prefectural Government Agencies (Directly-Managed Units), the three Development Zones, two districts (Yuhu District and Yuetang District), and three counties (Xiangxiang City, Shaoshan City, and Xiangtan County). For the purpose of this Assessment, the two districts and the three counties are excluded because they enjoy autonomy to prepare and submit their own fiscal and debt budgets to their respective People's Congress.

27. **This Assessment refers to Xiangtan Government's fiscal flows reflected in the Public Finance Budget (PFB) and Government Fund Budget (GFB).** Evaluating Xiangtan Government's debt repayment capacity is essential to determine its creditworthiness. By and large, such repayment capacity is related to the resources flowing through those two budgets—out of which funds can be appropriated to meet debt-service obligations. Besides, Xiangtan Government often re-shuffles resources between these two budgets via internal fund transfers. This Assessment is not concerned with the other two budgets run by Xiangtan Government: the Social Insurance Fund Budget (since it involves revenues strictly linked to social security activity, and thus cannot be used for debt repayments) and the State-Owned Capital Operation Budget (as it is very small and thus can be disregarded).

28. **This Assessment does not refer to four State-Owned Enterprises belonging to Xiangtan Government.** These state-owned enterprises are Jiaofa (a transport group), Chengfa (an urban development investment corporation, UDIC), an Industrial Group, and a Real Estate Group (under reform). They are not assessed since their linkages with Xiangtan Government's budgets are rather limited, and their revenues do not constitute repayment capacity available to service Xiangtan Government's debt.

V. FISCAL AND DEBT REGULATIONS IN HUNAN PROVINCE AND XIANGTAN PREFECTURE

29. Prudent, robust regulations on Xiangtan Government's debt management are provided by directives from the Central Government and the HPG. On top of the subnational debt regulations established by the Central Government (see section 2), HPG has also introduced stricter measures to control debt risks that all local governments in the province – including Xiangtan Government – must comply with. Some of these measures were supported by a World Bank Development Policy Loan in 2016 and contemplated international best practices. The most effective measures are the following:

(i) **Risk Classification and Early Warning System for local debt risks.** In 2018, HPG set up a Risk Classification and an Early Warning System for local debt risks, by issuing a publicly-available directive. Four types of government debt are addressed: government bonds, non-bond government debts (e.g., bank loans), contingent debts, and guaranteed debts funding public-welfare projects (which reportedly are considered 'hidden debt'). According to well-defined fiscal and debt indicators, the government debt risk is classified in four levels: Level I ('excessive risk'), Level II

(‘significant risk’), Level III (‘large risk’), and Level IV (‘general risk’). A conservative approach is taken whereby the higher level of risk is assigned whenever some indicators perform better than others (and thus no clear-cut judgement is apparent). HPG closely monitors sub-provincial government debt risks, and more importantly, it reduces the bond-issuance quota of local governments depending on their risk classification. In addition, HPG requires fiscal consolidation measures to local government whose risk classification deteriorates over time.

(ii) **Fiscal Consolidation Measures imposed on high-risk local governments.** In 2018, HPG **established** an obligation to contain expenditures for any local government exhibiting debt risk at Level I (‘excessive risk’) in the Risk Classification and Early Warning System, by issuing a confidential directive. The regulation, referred to as the ‘Zero Growth Standards’ by Hunan Provincial Finance Department and Provincial Performance Evaluation Committee Office, envisages five restrictive measures: (i) Zero expenditure for business trip abroad (except for specific investment attraction projects); (ii) Zero growth in official-activity expenses (including receptions, vehicles, consultations, business trips, and service fees); (iii) Zero expenditure for purchasing new official vehicles; (iv) PPP projects must be submitted to the Debt Management Division of Hunan Provincial Finance Department for examination and approval; and (iii) Cancellation of qualification for appraisal of ‘excellence performance’ in the annual assessment of the local government concerned. The implementation of this regulation has been very strict: in 2018, a total of 24 prefectural and county governments were restricted by those five measures; in 2019, a total of 10 are still subject to them.

(iii) **Reducing the number of platform companies.** In 2019, HPG issued a publicly-available directive to strictly control the number of platform companies that local government can arrange, in order to narrow opportunities for off-budget, hidden debt. The directive establishes that no more than 3 platform companies can exist at prefectural level; no more than 2 at county level; no more than 1 in a national-level industrial zone or in an administrative district; and no platform company shall be established at township level. In addition, the number of platform companies in provincial and subnational-level industrial zones shall be incorporated into prefectures or counties (county-level cities or districts). A platform company can set up a branch company, but not a subsidiary company.

30. **Reportedly, the government debt risk of Xiangtan Government was high in 2016 and 2017, but has been significantly reduced since 2018.** Risk levels for all sub-provincial governments in Hunan Province are confidential, including the specific numerical values of some fiscal and debt indicators used in the Risk Classification and Early Warning System. Reportedly, Xiangtan Government’s risk classification is high and restrictive measures have been adopted in 2019. Concerning compliance with debt ceilings established by regulations issued by the Central Government, reportedly, Xiangtan Government’s general debt is within its prudent ceiling while the special debt breaches its respective ceiling. The Central Government preserves confidentiality concerning the definition and calculation of these debt ratios. Reportedly, in broad terms, a debt ratio refers to a debt stock (numerator, as a proxy for cumulative debt-service obligations) and a measure of essential expenditures (denominator, as a proxy for resources that cannot be used for debt-service payments). Xiangtan Government’s comprehensive debt ratio - including both types of debts - was around 125% in 2016 and 2017, and declined to 76% in 2018. The individual ratios for general debt and special debt, respectively, were around 45% and 300% in 2016 and

2017, and declined to 62% and 148% in 2018. Therefore, from a regulatory viewpoint, Xiangtan Government exhibits high risk debt but is has improved significantly since 2018.

VI. FISCAL AND DEBT PERFORMANCE OF XIANGTAN GOVERNMENT (2015–2018)

31. **Xiangtan Government is a middle-sized fiscal body for Hunan Province's standards (Chart 2 and 3).** In 2018, Xiangtan's revenues amounted to CNY 11.3 billion in the PFB (which includes taxes, non-tax revenue, transfers from upper-level of government, and proceeds from issuance of government general bonds), and CNY 13.9 billion in the GFB (which includes land use-right leasing revenues and proceeds from issuance of government special bonds). On the other hand, expenditures (including debt-service payments) totaled CNY 13.9 billion in the PFB and CNY 11.4 billion in the GFB.[5] The GFB transferred funds to the PFB by CNY 2.6 billion in 2018; by doing so, the GFB surplus (i.e., excess revenue over expenditure, for actuals) ultimately funded the PFB deficit (i.e., excess expenditure over revenue, for actuals).[6]

32. **While tax revenues have significantly increased and transfer from upper-level of government are fairly stable, non-tax revenues are weakening due to Central Government's policy to reduce local administrative fees and charges.** In 2014–2018, Xiangtan Government's tax revenues increased at an annual average growth rate of 12% and reached CNY 4.2 billion in 2018. Transfers from upper-level of government increased at an annual average growth rate of 3% and reached CNY 3.5 billion in 2018. Non-tax revenues, on the other hand, remained stagnant around CNY 3.4 billion in 2014–2017 and dropped to CNY 2.6 billion in 2018. Proceeds from issuance of government general bonds are relatively small, estimated not to exceed CNY 1 billion per year in 2015–2018, in net terms (i.e., after principal payments of maturing general bonds and debts).

33. **Land use-right leasing revenues has been largely mobilized to honor debt-service obligations, while proceeds from issuance of government special bonds are decreasing to contain debt risks.** In 2014–2016, Xiangtan Government's land use-right leasing revenues averaged only CNY 1.2 billion. More recently, as Xiangtan Government's debt-service obligations started to mount and HPG tightened its advice to mobilize more local revenues and de-leverage, Xiangtan Government engaged in sizable auctions of land use-rights. It then collected CNY 3.6 billion in 2017 and CNY 7.6 billion in 2018 – thus largely strengthening resources flowing into the GFB. Proceeds from issuance of government special bonds have declined from CNY 7.1 billion in 2016 to CNY 5.7 billion in 2018, in gross terms (i.e., prior to principal payments of maturing special bonds and debts). Reduced gross indebtedness flows sought to de-leverage and thus mitigate debt risks facing the Xiangtan Government.

34. **Public expenditure has increased and currently is concentrated in promoting social development in the city.** In 2014–2018, Xiangtan Government's expenditure in the PFB increased at an annual average growth rate of 9% and reached CNY 13.9 billion in 2018. The

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[5] As per current reporting practices by subnational governments in Hunan Province, the PFB presents the net borrowing from general bonds (i.e., gross issuances minus principal payments falling due) among revenue sources; the GFB separately reports both gross issuances (as a revenue source) and principal payments (as expenses); and all interest payments are in PFB.

[6] For consistency with the current reporting practices referred to in the previous footnote, the revenues and expenditures involved in calculating GFB surplus and PFB deficit include proceeds from debt issuances and expenses for debt repayments (principal). In other reporting practices, admittedly, these items would be deemed as 'below-the-line' transactions and therefore excluded from calculations of budget surplus or deficit.

most important expenses promote social development and include general public service expenditure (which accounts for 13% of total expenditure in 2018), social security and employment expenditure (17%), and urban and rural community expenditure (20%). Expenditure in GFB (excluding principal payments and funds transferred to the PFB) averaged just CNY 1.4billion in 2014–2016, but increased to CNY 2.3 billion in 2017 and further to CNY 7.8 billion in 2018.

35. **Xiangtan Government's debt is high but has remained broadly stable in 2015-2018 (Chart 4).** Government debt is defined as financial obligations the Xiangtan Government is liable for. It includes 'general debt' (to be repaid from budget resources) and 'special debt' (to be repaid from income generated by public-purpose projects), and excludes liabilities from income-generating, commercial-purpose projects. Xiangtan Government debt amounted to CNY 26.2 billion at end-2018, of which CNY 8.6 billion is 'general debt' and CNY 17.6 billion is 'special debt'. Total government debt has been broadly stable in 2015–2018, fluctuating in a range between CNY 19.3 billion and CNY 26.2 billion.

36. **New debt issuances (i.e., gross borrowings) are largely funding repayments (i.e., principal) of maturing liabilities.** In 2015–2018, on average, annual proceeds from issuing both types of government debt amounted to CNY 6.8 billion, while the annual principal payments totaled CNY 6.7 billion. Thus far, HPG has never rejected an application from Xiangtan Government for the issuance of bonds for the purpose of repaying maturing bonds or debts, or for the purpose of swapping old liabilities.

37. **Xiangtan Government's debts are contracted under affordable financing terms.** Both general and special debts carry low interest rates (averaging 4% per annum), enjoy medium- to long-maturities (from 5 to 10 years), and are denominated in local currency. As it is customary in the PRC, subnational bonds are held by banks and financial institutions that take advantage of these instruments to maintain a liquid asset position. Therefore, the Xiangtan Government is narrowly exposed to rollover risks and interest rate risks, and not exposed to currency risk at all.

VII. FISCAL AND DEBT PROSPECTS FOR XIANGTAN GOVERNMENT (2019-2030)

38. **Xiangtan Government is currently consolidating its budget to cope with the Central Government's policy to reduce local administrative fees and charges.** In 2019, the Government has estimated a loss (shortfall) of revenue around CNY 1.7 billion due to the reduction of fees and charges. Administrative measures are being taken to identify budget savings, especially by rationalizing current expenses.

39. **Measures to mobilize additional revenue are being considered by the Xiangtan Government.** In the past, land use-right leasing revenue has often been used as a last-resort source of income to cope with cash shortfalls or to de-leverage (i.e., funding the servicing of maturing debts). The Government has room to continue resorting to auctions of land use-right leases (as it did in since 2017) to secure financing and de-leverage, with an estimated annual revenue around CNY 5 billion. Real estate prices have been stable in Xiangtan city and thus those auctions should be a reliable source of income in the next few years. Besides, the Xiangtan Government is considering options to increase non-tax revenue, e.g., parking fees, in the context of XLCTSDP.

Debt Sustainability Analysis

40. **Xiangtan Government's public finances are sustainable in the medium- to long-term, as assessed in a Debt Sustainability Analysis.** A forward-looking Debt Sustainability Analysis is undertaken to assess the expected, future performance of key government debt indicators. Projections extend over the period 2019–2030 and are predicated upon Xiangtan Government's fiscal and debt policies, HPG's regulatory actions concerning debt risk management at sub-provincial level, and own estimates on economic growth in Xiangtan City.

41. **Xiangtan Government's Debt Sustainability Analysis relies on scenarios and projections of debt indicators.** Two scenarios are formulated: A 'Baseline Scenario' reflecting expected trends and policies in the absence of XLCTSDP (i.e., a 'business-as-usual case'), and a 'project scenario' envisaging the public-finance implications of XLCTSDP. Government debt indicators utilized to evaluate prospective performance are the debt-to-revenue ratio and the debt service-to-revenue ratio. The former ratio measures the overall burden of government debt (stock) relative to Xiangtan Government's repayment capacity, while the later measures the annual financial obligation associated to interest and principal payments (flows) relative to repayment capacity.

42. The remaining of this section reports the key assumptions and results corresponding to both scenarios, and their respective projections are presented in Table 5 and 6.

Baseline Scenario

43. **Xiangtan City's economic activity is expected to continue expanding, although at lower growth rates than those achieved in recent years.** The anticipated slowdown in nation-wide Chinese economy – mainly due to re-balancing the economic structure between manufacturing and services, as well as the sources of aggregate demand between investment and consumption – will impact the growth potential of both Hunan Province and Xiangtan City. Xiangtan City's real GDP is projected to grow at 6% per annum in the next decade, thus largely slowing down relative to the average growth of 11% achieved in the preceding decade (2009-2018). Factoring-in an annual inflation rate of 2%, nominal GDP would expand at nearly 8% per year going forward.[7] Lack of data prevents the analysis of prospective growth performance disaggregated by economic sectors at city-level, i.e., services, manufacturing, and agriculture.

44. **Xiangtan Government's revenue will perform in line with local economic activity, the existing arrangements on intergovernmental transfer system, and an active mobilization of land-related proceeds.** As for revenues flowing into the PFB, taxes and non-tax revenues are expected to increase at an average annual growth rate of 8% (i.e., in line with nominal GDP), while transfers from upper-level government expand at 3.5% (thus continuing trends observed in recent years). Concerning revenues feeding into the GFB, annual proceeds from land use-right leasing are expected to be CNY 5 billion in 2019–2021 and CNY 4 billion from 2022 onwards, and other minor revenues are assumed to grow at 8% per year.

45. **COVID-19 could deteriorate the short-term prospects for economic growth in Xiangtan City and the fiscal revenue Xiangtan Government, but it is not expected to**

[7] Lack of information and data prevents the analysis of prospective growth performance disaggregated by economic sectors at city-level, i.e., services, manufacturing, and agriculture.

deteriorate the medium- to long-term potential for these variables. While COVID-19 pandemics may impact on the economic activity and taxes collected, its effects are likely to be restricted to late 2019 and 2020, thus implying a downward risk for the short-term outlook underpinning the Baseline Scenario. No effects are to be expected in the medium- to long-term, though, which is the time frame pertinent to assess fiscal and debt sustainability of the Xiangtan Government. Hence, the Baseline Scenario's projections extending for more than a decade still hold despite of the short-term effect of the pandemics.

46. **Xiangtan Government's expenditures will also broadly support the expansion of local economic activity, although growing at rates slightly lower than in recent years in order to** consolidate **the budget.** As for spending in the PFB, it is expected that different expenses increase at annual rates between 6% and 7% (i.e., slightly below revenues). Concerning spending in the GFB, expenditure is assumed to be CNY 2 billion in 2019-2025 and CNY 2.5 billion from 2026 onwards.

47. **Proceeds from issuances of government general bonds and special bonds – which provide resources to PFB and GFB, respectively - will ensure repayment of maturing debt, as per current debt policies followed by HPG and Xiangtan Government.** Current debt policies - aimed at mitigating debt risks, preserving financial stability, and satisfying policy banks' appetite for subnational bonds as a liquid-asset investment position - are anticipated to continue in future years. Accordingly, at a minimum, the gross issuances (borrowings) must be sufficient to honor maturing liabilities. The corresponding assumption is made in the scenario's projections.

48. **On top of minimum gross borrowing requirements to repay maturing debt indicated above, the additional resources secured via bond issuances are expected to be limited.** Additional resources - on top of those necessary to fund principal payments – are used to finance government spending. In view of current policies to mitigate debt risks through de-leveraging, future 'net borrowing' (i.e., gross borrowing minus principal payments) will be restricted and closely monitored. It is then assumed that throughout the period 2019–2025, the average annual net borrowing will amount to CNY 1 billion from general bonds and CNY 0.7 billion from special bonds; afterwards, larger net indebtedness flows are expected.[8] In the scenario's projections, the annual net borrowings account for the variation in the stock of government general and special debts.[9]

49. **Xiangtan Government's bonds will continue carrying soft financing terms, thus alleviating the burden of debt-service obligations (i.e., interest and principal).** In line with issuances observed in 2017–2018, it is assumed that government general and special bonds will have a bullet repayment schedule, with a 7-year and 5-year maturity, respectively. Both types of bonds are also assumed to carry a 4 percent interest rate and be denominated in local currency. These financing terms determine the projected annual debt-service obligation for Xiangtan Government, i.e., interest payments (reflected in the PFB for both types of debts) and principal payments (which are subtracted from general-debt borrowings in the PFB, while reflected in the GFB for special debts).

[8] Projections are presented following the current reporting practice by subnational governments in Hunan Province.

[9] Debt stock projections are largely driven by net borrowings because: (i) liabilities are denominated in local currency and therefore there is no valuation effects resulting from exchange rate fluctuations; and (ii) debt buybacks, if any, are expected to be of a rather small magnitude (see next footnote).

50. **GFB's surpluses are expected to continue funding PFB's deficits via transfers between these two budgets.** Substantial proceeds from land use-right leasing were mobilized recently and resulted in a GFB surplus, which was transferred to the PFB to fund its own deficit. This policy is likely to continue in the next few years, particularly in view of the planned, sizable auctions of land use-rights. Thus, projections assume that GFB's excess revenue over spending will be available for funding PFB's excess spending over revenue.[10] Given forecasts for GFB's and PFB's revenues and expenditures, the estimated annual fund transfers average CNY 3.8 billion in 2019–2030. Incidentally, this level of fund transfers is slightly below the expected annual land use-right leasing revenues.

51. **Projected debt indicators suggest Xiangtan Government's public finances are sustainable in the medium- to long-term.** Predicated upon the economic and policy assumptions underpinning the Baseline Scenario, Xiangtan Government's debt is projected to increase from CNY 26.2 billion at end-2018 to CNY 37.8 billion in 2025, and further to CNY 59.2 billion by 2030.[11] Special debt is expected to decrease its share in total government debt, from two-thirds in 2018 to two-fifths by 2023. The debt-to-revenue indicator appreciates the debt stock relative to Xiangtan Government's repayment capacity, and suggest the overall debt burden will increase: The ratio is projected to raise from 142% in 2018 to 179% in 2025 and further to 212% by 2030. However, this result is mainly due to including the land use-right leasing proceeds (which are stable in nominal terms throughout the projection horizon) as revenues. If these proceeds are excluded, the debt indicator remains stable within a range between 215% and 250%, thus suggesting a sustainable debt position going forward.[12]

52. **Projected debt indicators also suggest Xiangtan Government's debt-service obligations are affordable in the medium- to long-term.** Xiangtan Government's annual debt-service obligations (i.e., interest and principal payments) are projected to increase from CNY 2.3 billion in 2018 to CNY 6.1 billion in 2025, and further to CNY 9.7 billion by 2030. The debt service-to-revenue indicator appreciates the debt-service flow relative to Xiangtan Government's repayment capacity, and suggest the annual financial obligation associated to interest and principal payments will not become excessive: The ratio is projected to decline from an average of 48% in 2016–2018 to 35% by 2030.[13] If land use-right leasing proceeds are excluded from revenues, the debt-service indicator remains within a range between 35% and 50% (to be compared against an average of 58% in 2016–2018), thus suggesting an affordable debt servicing going forward.

Project Scenario

53. **The Project will have a limited impact on the Xiangtan Government's fiscal and debt position.** The expenditure and financial flows associated with the execution of XLCTSDP and the

[10] Besides, for purely model-closure purposes, any remaining surplus in the GFB is assumed to be used for buying back government special bonds. In the projections, the annual debt buybacks (if any) are very small and average only CNY 0.2 billion per year in 2019–2030.

[11] In other words, the debt grows at an average annual rate of 7% in 2019–2030.

[12] Another widely-used debt indicator measures the debt stock relative to the City's nominal GDP (which is a proxy for the income generated by the local economy as a whole). This indicator is projected to remain broadly stable throughout the projection horizon: While the nominal GDP grows at an average annual rate of 8%, the debt grows at 7%, as reported in the previous footnote. This result also suggests the Xiangtan Government's debt position is sustainable in the medium- to long-term.

[13] As the annual debt-service payments in 2016–2018 were very volatile, the comparison is made against the historical average during those three years.

arrangements for the ADB Loan are relatively small compared to the flows envisaged in the Baseline Scenario. Therefore, the Xiangtan Government's fiscal and debt position will not be undermined by the Project and its underlying financing arrangements. Similarly, while positive effects are expected in terms of social and economic development, the projected City's growth, revenue, and expenditure (excluding the Project itself) are likely to remain in line with the Baseline Scenario.

54. For analytical purposes, the Project is treated as a public-purpose project and its expenditure and financial flows are contemplated in the GFB. Specifically, the project-related spending is recorded in the GFB, as well as the loan proceeds and principal payments; on the other hand, the interest payments are reflected in the PFB, as per current budgeting practices in Hunan Province.14 It is assumed that project execution drives the disbursement of investment financing by $150 million over the period 2021–2025, while the policy-based loan (budget support) by $50 is fully disbursed in 2020. Interest and principal payments related to the ADB loan reflect the financing terms of both components: Investment financing loan has 25-year maturity, 5-year grace, an increasing repayment schedule (where annual principal payments grow by 10% per year from 2026 to 2045); and the policy-based loan (budget support) has 15-year maturity, 3-year grace, an increasing repayment schedule (where annual principal payments grow by 20% per year from 2023 to 2034).

55. **The policy-based loan contributes to meeting the Xiangtan Government's financing needs in 2020, although to a small extent**. Financing needs and borrowing requirements are hereby defined according to international practice, although applied to municipal-level public finances rather than national-level ones. Financing <u>needs</u> are calculated as the consolidated fiscal deficit in the PFB and the GFB *plus* the amortization payments of maturing liabilities.[15] The consolidated fiscal deficit in the PFB and the GFB excludes the proceeds from all debt issuances and the land use-right leasing revenue, as both items are considered as financing <u>sources</u>. Borrowing requirements are calculated as the difference between financing needs and the land use-right leasing revenue; thus, the borrowing requirements are to be met by all debt issuances. In 2020, Xiangtan Government's financing needs are estimated to be CNY 10.5 billion, of which 55% derives from the consolidated fiscal deficit and 45% results from the amortization payments of maturing liabilities. Xiangtan Government's borrowing requirements are expected to be CNY 5.5 billion, and met mainly through issuance of general and special debts. The US$50 million policy-based loan, therefore, provides just 3.5% of the estimated financing needs and 6.5% of the borrowing requirements. Despite of the loan being fairly small relative to the financing needs and borrowing requirements, its absolute size is commensurate with the strength of the reforms and the economic benefits of the government reform agenda.

56. **Xiangtan Government's debt position remains sustainable when the ADB loan is considered, and the debt-service obligations continue to be affordable.** The size of ADB loan is small relative to the existing debt stock, and in addition, the annual debt-service obligations associated to the ADB loan are even more favorable than those resulting from the existing financial liabilities. In the Project Scenario, the debt-to-revenue ratio (excluding land use-right leasing proceeds) remains within a range between 215% and 255%, thus broadly unchanged relative to the Baseline Scenario. The debt service-to-revenue ratio (excluding land use-right

[14] Utilizing the GFB to analyze expenditure and financial flows facilitates the presentation of results. Projections of debt indicators are identical regardless of whether the GFB or the PFB be used to record those flows.

[15] Expenditure data provided by the Xiangtan Government follow a functional classification and hence it is not possible to accurately identify the expenses in capital projects - particularly within the PFB – that is included in the consolidated fiscal deficit. In the GFB alone, the capital expenses in 2020 are at least CNY 2 billion.

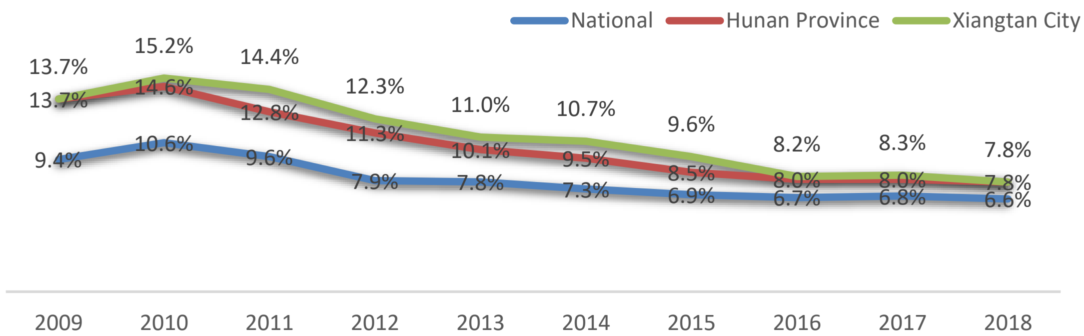
leasing proceeds) fluctuates within a range between 35% and 50%, just as it does in the Baseline Scenario.

Assessment Concerning Sustainability of Public Finances

57. **Xiangtan Government's public finances and policy framework are deemed adequate for the purpose of the Project.** Regulations and policies in place, formulated by the Central Government, the HPG, and/or the Xiangtan Government provide robust guidance, incentives, and constraints to ensure prudent fiscal and debt management by the Xiangtan Government including mitigating debt risks. In addition, the prospects for economic and budget performance suggest the fiscal and debt positions are sustainable. Debt indicators, in particular, are not expected to weaken if the ADB financing supporting XLCTSDP is added to the Xiangtan Government's financial obligations. Against this background, public finances and policy framework are deemed adequate for the purpose of XLCTSDP.

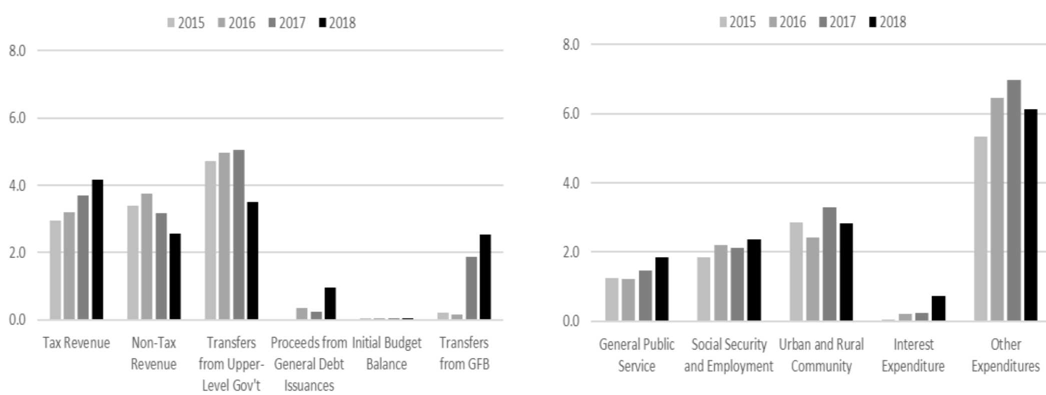
CHARTS

Chart 1: The PRC, Hunan and Xiangtan: GDP Growth Rate (2009–2018)



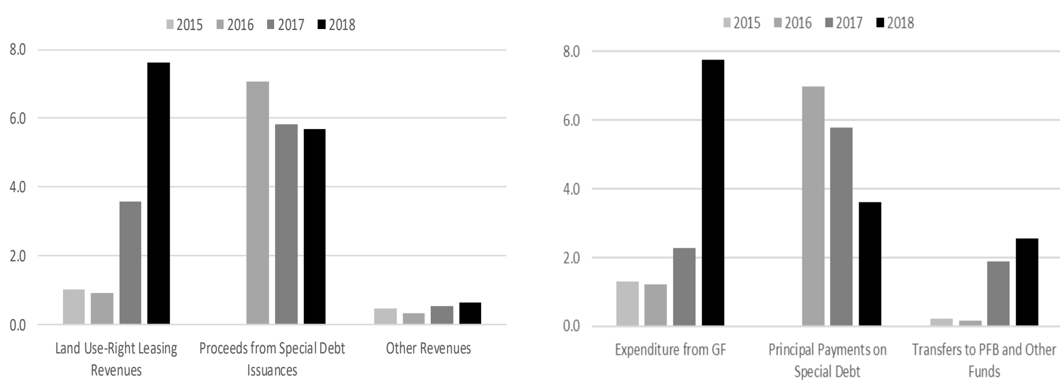
Data Source: The PRC's National Statistics Bureau and Xiangtan Statistic Bureau

Chart 2: Xiangtan Government – Public Finance Budget (2015–2018, CNY billion)



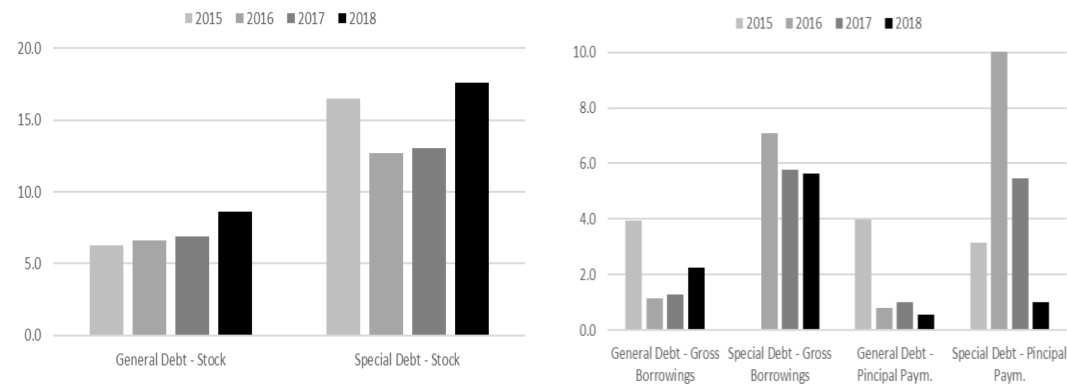
Data Source: Xiangtan Finance Bureau

Chart 3: Xiangtan Government – Government Fund Budget (2015–2018, CNY billion)



Data Source: Xiangtan Finance Bureau

Chart 4: Xiangtan Government – General Debt and Special Debt (2015–2018, CNY billion)



Data Source: Xiangtan Finance Bureau

TABLES

Table 1: PRC, Hunan and Xiangtan: Population and GDP (2018)

Map	Items	PRC	Hunan Province	Xiangtan City
	Area (in thousand km²)	9634	211.8	5.01
	Pop (in million)	1395	68.99	2.87
	--Ranking	1st	7th	12th
	Urban Pop (in percent)	59.58 %	56.02%	62.9%
	--Ranking	——	19th	
	GDP (in billion)	90031	3643	216
	--Ranking	2nd	8th	7th
Beijing; Hunan Province; Xiangtan City	GDP pc (in thousand)	64.52	52.95	75.61
	--Ranking	72nd	16th	2nd

Note: Rankings for the PRC, Hunan and Xiangtan refer to ones over the world, in 31 provinces of the PRC and in 14 prefectures of Hunan province respectively.

Data Sources: IMF Database and the PRC's National Bureau of Statistics

Table 2: Delineation of Functionalities between Central and SNGs

	CENTRAL GOVERNMENT'S FUNCTIONALITIES	SUBNATIONAL GOVERNMENTS' FUNCTIONALITIES	SHARED FUNCTIONALITIES
CRITERION	safeguarding national security, maintaining integrated domestic market, enhancing social fairness and justice, or promoting coordinated regional development	benefiting specific regions, involving more complicated information and closely related to residents	reflecting central strategic objectives, crossing provinces and requiring local information
FUNCTIONALITIES	National defense, foreign affairs, state security, cross-border immigration management, cross-border highway, river and lake treatment, national major infectious disease prevention, national transportation channel, national strategic natural resources exploitation and protection	public security, municipal transportation, rural roads, urban and rural community affairs	Compulsory education, higher education, research and development, public culture, basic pension, basic medical care and public health, basic medical insurance, employment, food security, cross-province major infrastructure project construction, environmental protection and treatment

Source: The State Council Document No. 49, 2016

Table 3: PRC, Hunan and Xiangtan: Tax Sharing Arrangements (2019)

Items	*Central*	*Hunan*	
		Province	**Xiangtan(Prefect.)**
1. VAT	50%	13%	38%
2. Business Tax	0%	0%	0%
3. Enterprise Income Tax	60%	12%	28%
4. Individual Income Tax	60%	12%	28%
5. Resource Tax	0%	25%	75%
6. Urban maintenance and construction tax	0%	0%	100%
7. Property Tax	0%	0%	100%
8. Stamp duty	0%	0%	100%
9. Urban Land Use Tax	0%	30%	70%
10. Vehicle and Vessel Tax	0%	0%	100%
11. Land Value Added Tax	0%	0%	100%
12. Land Occupancy Tax	0%	0%	100%
13. deed tax	0%	0%	100%
14. Environmental Protection Tax	0%	30%	70%
15. Consumption Tax	100%	0%	0%

Source: Information provided by Xiangtan's Bureau of Finance on Sept, 2019

Table 4. Xiangtan's Administrative and Fiscal Jurisdiction

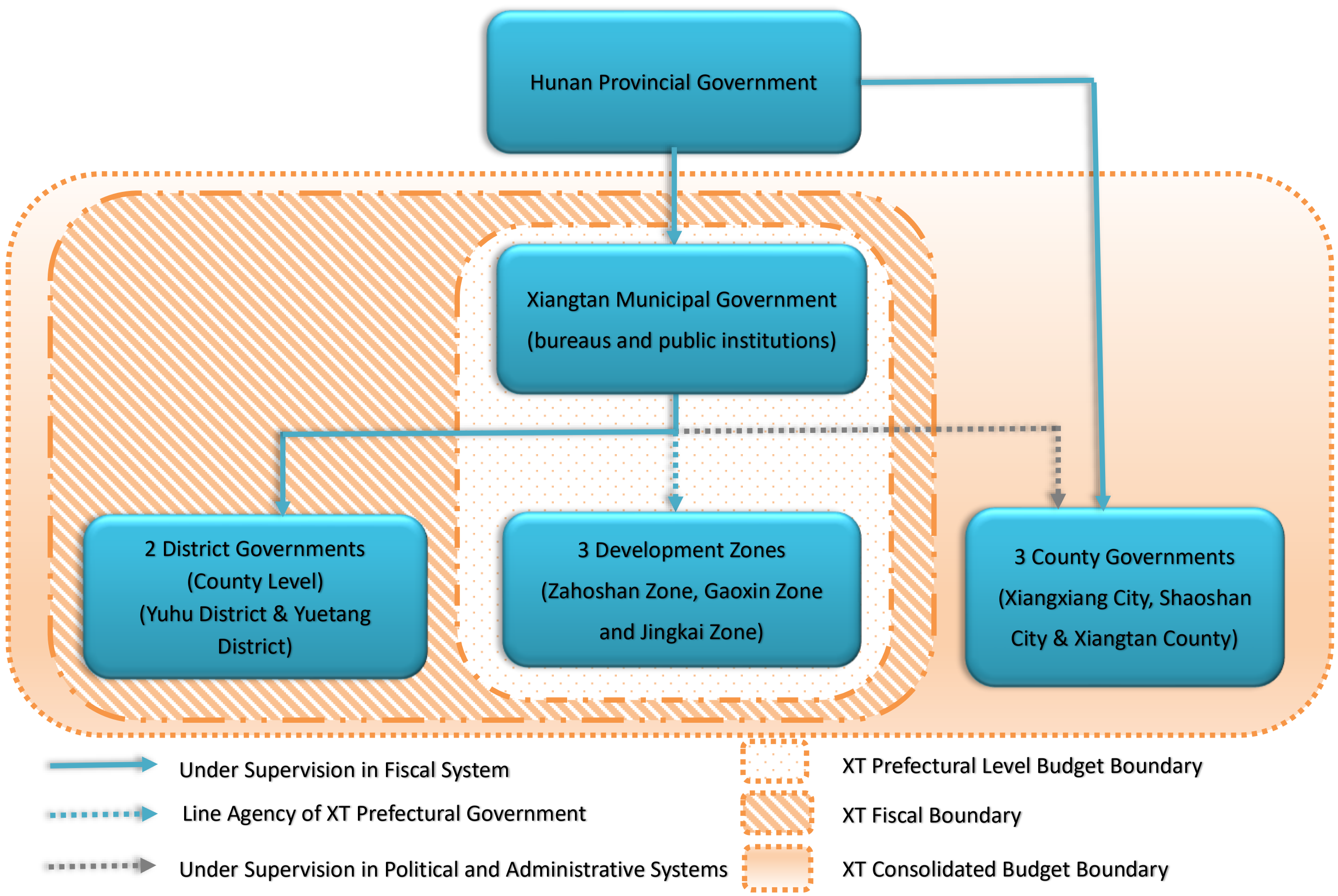


Table 5. Fiscal and Debt Prospects for Xiangtan Government – Baseline Scenario

		Historical	Estimate	Forecast --->										
Billion RMB	**Assumptions**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Public Finance Budget (PFB)														
PFB Revenue		**13.810**	**15.072**	**16.008**	**16.911**	**18.083**	**19.231**	**20.548**	**21.911**	**23.245**	**24.940**	**26.625**	**28.423**	**30.344**
Tax Revenue	AGR 8%	4.168	4.501	4.862	5.251	5.671	6.124	6.614	7.143	7.715	8.332	8.998	9.718	10.496
Non-Tax Revenue	AGR 8%	2.565	2.771	2.992	3.232	3.490	3.769	4.071	4.396	4.748	5.128	5.538	5.981	6.460
Transfers from Upper-Level Gov't	AGR 3.5%	3.501	3.624	3.750	3.882	4.018	4.158	4.304	4.454	4.610	4.772	4.939	5.112	5.290
Proceeds from General Debt Issuances	Link to Net Borrowing	0.971	0.774	0.774	0.774	1.274	1.274	1.274	1.774	1.500	2.500	3.500	4.000	5.000
Initial Budget Balance	Assumed 0	0.055	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Transfers from GFB	Link to GFB	2.551	3.402	3.630	3.773	3.631	3.906	4.285	4.142	4.672	4.209	3.649	3.612	3.098
PFB Expenditure		**13.898**	**15.072**	**16.008**	**17.012**	**18.083**	**19.275**	**20.548**	**21.911**	**23.368**	**24.940**	**26.625**	**28.423**	**30.344**
General Public Service	AGR 7%	1.849	1.978	2.117	2.265	2.424	2.593	2.775	2.969	3.177	3.399	3.637	3.892	4.164
Social Security and Employment	AGR 7%	2.361	2.527	2.704	2.893	3.095	3.312	3.544	3.792	4.057	4.341	4.645	4.971	5.318
Urban and Rural Community	AGR 7%	2.830	3.029	3.241	3.467	3.710	3.970	4.248	4.545	4.863	5.204	5.568	5.958	6.375
Interest Expenditure	Link to Interest Paym.	0.734	1.048	1.068	1.094	1.124	1.206	1.296	1.398	1.512	1.652	1.809	1.981	2.166
Other Expenditures	AGR 6%	6.123	6.490	6.880	7.292	7.730	8.194	8.685	9.206	9.759	10.344	10.965	11.623	12.320
Government Fund Budget (GFB)														
GFB Revenue		**13.928**	**9.184**	**9.238**	**9.297**	**9.361**	**9.430**	**10.004**	**10.085**	**10.672**	**11.265**	**11.367**	**11.476**	**11.594**
Land Use-Right Leasing Revenues	Assumed range RMB4-5bn	7.624	5.000	5.000	5.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000
Proceeds from Special Debt Issuances	Link to Gross Borrowing	5.671	3.500	3.500	3.500	4.500	4.500	5.000	5.000	5.500	6.000	6.000	6.000	6.000
Other Revenues	AGR 8%	0.633	0.684	0.738	0.797	0.861	0.930	1.004	1.085	1.172	1.265	1.367	1.476	1.594
GFB Expenditure		**13.928**	**9.184**	**9.238**	**9.297**	**9.361**	**9.430**	**10.004**	**10.085**	**10.672**	**11.265**	**11.367**	**11.476**	**11.594**
Expenditure from GF	Assumed range RMB2-2.5bn	7.759	2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.500	2.500	2.500	2.500	2.500
Principal Payments on Special Debt	Link to Principal Paym.	3.618	3.525	3.525	3.525	3.525	3.525	3.500	3.500	3.500	4.500	4.500	5.000	5.000
Transfers to PFB and Other Funds	Ensures PFB balance	2.551	3.402	3.630	3.773	3.631	3.906	4.285	4.142	4.672	4.209	3.649	3.612	3.098
Buyback Special Bonds	Ensures GFB balance	0.000	0.257	0.084	0.000	0.206	0.000	0.219	0.442	0.000	0.057	0.717	0.364	0.996
MEMO														
PFB Deficit = Expenditure MINUS Revenue (excl. Transfer from GFB)		2.638	3.402	3.630	3.874	3.631	3.949	4.285	4.142	4.795	4.209	3.649	3.612	3.098
GFB Surplus = Revenue MINUS Expenditure (excl. Transfer to PFB)		2.551	3.402	3.630	3.773	3.631	3.906	4.285	4.142	4.672	4.209	3.649	3.612	3.098

Table 5. Fiscal and Debt Prospects for Xiangtan Government – Baseline Scenario (cont.)

		Historical	Estimate	Forecast --->										
Billion RMB	**Assumptions**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Debt, Borrowings, and Debt Service														
Debt (stock)		**26.203**	**26.696**	**27.362**	**28.111**	**30.155**	**32.405**	**34.960**	**37.792**	**41.292**	**45.235**	**49.518**	**54.154**	**59.158**
General Debt	Δ Deuda = Net Borrowing	8.581	9.355	10.129	10.903	12.177	13.452	14.726	16.500	18.000	20.500	24.000	28.000	33.000
Special Debt	Δ Deuda = Net Borr. - Buyback	17.623	17.341	17.233	17.208	17.978	18.954	20.234	21.292	23.292	24.735	25.518	26.154	26.158
Gross Borrowing (flow)		**7.872**	**5.500**	**5.500**	**5.500**	**7.000**	**7.000**	**7.500**	**8.000**	**9.000**	**10.500**	**11.500**	**12.500**	**13.500**
General Debt	Assumed range RMB2-7bn	2.251	2.000	2.000	2.000	2.500	2.500	2.500	3.000	3.500	4.500	5.500	6.500	7.500
Special Debt	Assumed range RMB5-7bn	5.621	3.500	3.500	3.500	4.500	4.500	5.000	5.000	5.500	6.000	6.000	6.000	6.000
Principal Payments (flow)		**1.548**	**4.750**	**4.750**	**4.750**	**4.750**	**4.750**	**4.726**	**4.726**	**5.500**	**6.500**	**6.500**	**7.500**	**7.500**
General Debt	Debt with 7-yr maturity	0.546	1.226	1.226	1.226	1.226	1.226	1.226	1.226	2.000	2.000	2.000	2.500	2.500
Special Debt	Debt with 5-yr maturity	1.002	3.525	3.525	3.525	3.525	3.525	3.500	3.500	3.500	4.500	4.500	5.000	5.000
Interest Payments (flow)		**0.795**	**1.048**	**1.068**	**1.094**	**1.124**	**1.206**	**1.296**	**1.398**	**1.512**	**1.652**	**1.809**	**1.981**	**2.166**
General Debt	Debt with 4% interest rate	0.275	0.343	0.374	0.405	0.436	0.487	0.538	0.589	0.660	0.720	0.820	0.960	1.120
Special Debt	Debt with 4% interest rate	0.520	0.705	0.694	0.689	0.688	0.719	0.758	0.809	0.852	0.932	0.989	1.021	1.046
Net Borrowing (flow)		**6.323**	**0.750**	**0.750**	**0.750**	**2.250**	**2.250**	**2.774**	**3.274**	**3.500**	**4.000**	**5.000**	**5.000**	**6.000**
General Debt	Gross Borrowing minus Princ.Paym.	1.704	0.774	0.774	0.774	1.274	1.274	1.274	1.774	1.500	2.500	3.500	4.000	5.000
Special Debt	Gross Borrowing minus Princ.Paym.	4.619	-0.024	-0.024	-0.024	0.976	0.976	1.500	1.500	2.000	1.500	1.500	1.000	1.000
Debt and Debt Service Indicators														
Debt Stock as % of Revenue (*)		142	161	158	155	167	171	175	179	186	193	199	206	212
Debt Service as % of Revenue (*)		13	35	34	32	33	31	30	29	32	35	33	36	35
Debt Stock as % of Revenue (excl. land-related rev.) (**)		241	231	222	214	215	216	219	221	226	232	238	243	248
Debt Service as % of Revenue (excl. land-related rev.) (**)		22	50	47	44	42	40	38	36	38	42	40	43	41

Notes:

(*) Revenue includes: Tax Revenue, Non-Tax Revenue, Transfers from Upper-Level Gov't, and Land Use-Right Leasing Revenues

(**) Revenue includes: Tax Revenue, Non-Tax Revenue, and Transfers from Upper-Level Gov't

Table 6. Fiscal and Debt Prospects for Xiangtan Government – Project Scenario

		Historical	Estimate	Forecast --->										
Billion RMB	**Assumptions**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Public Finance Budget (PFB)														
PFB Revenue		**13.810**	**15.072**	**16.008**	**16.911**	**18.083**	**19.222**	**20.555**	**21.918**	**23.211**	**24.958**	**26.656**	**28.457**	**30.379**
Tax Revenue	AGR 8%	4.168	4.501	4.862	5.251	5.671	6.124	6.614	7.143	7.715	8.332	8.998	9.718	10.496
Non-Tax Revenue	AGR 8%	2.565	2.771	2.992	3.232	3.490	3.769	4.071	4.396	4.748	5.128	5.538	5.981	6.460
Transfers from Upper-Level Gov't	AGR 3.5%	3.501	3.624	3.750	3.882	4.018	4.158	4.304	4.454	4.610	4.772	4.939	5.112	5.290
Proceeds from General Debt Issuances	Link to Net Borrowing	0.971	0.774	0.774	0.774	1.274	1.274	1.274	1.774	1.500	2.500	3.500	4.000	5.000
Initial Budget Balance	Assumed 0	0.055	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Transfers from GFB	Link to GFB	2.551	3.402	3.630	3.773	3.631	3.897	4.292	4.150	4.638	4.226	3.680	3.645	3.133
PFB Expenditure		**13.898**	**15.072**	**16.008**	**17.012**	**18.083**	**19.282**	**20.555**	**21.918**	**23.398**	**24.970**	**26.656**	**28.457**	**30.379**
General Public Service	AGR 7%	1.849	1.978	2.117	2.265	2.424	2.593	2.775	2.969	3.177	3.399	3.637	3.892	4.164
Social Security and Employment	AGR 7%	2.361	2.527	2.704	2.893	3.095	3.312	3.544	3.792	4.057	4.341	4.645	4.971	5.318
Urban and Rural Community	AGR 7%	2.830	3.029	3.241	3.467	3.710	3.970	4.248	4.545	4.863	5.204	5.568	5.958	6.375
Interest Expenditure	Link to Interest Paym.	0.734	1.048	1.068	1.094	1.124	1.214	1.303	1.406	1.542	1.681	1.840	2.014	2.202
Other Expenditures	AGR 6%	6.123	6.490	6.880	7.292	7.730	8.194	8.685	9.206	9.759	10.344	10.965	11.623	12.320
Government Fund Budget (GFB)														
GFB Revenue		**13.928**	**9.184**	**9.588**	**9.430**	**9.711**	**9.759**	**10.206**	**10.119**	**10.672**	**11.265**	**11.367**	**11.476**	**11.594**
Land Use-Right Leasing Revenues	Assumed range RMB4-5bn	7.624	5.000	5.000	5.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000	4.000
Proceeds from Special Debt Issuances	Link to Gross Borrowing	5.671	3.500	3.500	3.500	4.500	4.500	5.000	5.000	5.500	6.000	6.000	6.000	6.000
Other Revenues	AGR 8%	0.633	0.684	0.738	0.797	0.861	0.930	1.004	1.085	1.172	1.265	1.367	1.476	1.594
ADB-XT Project: Proceeds from ADB Loan	Link to ADB-XT Project: Expenditure			0.350	0.132	0.350	0.328	0.201	0.034					
GFB Expenditure		**13.928**	**9.184**	**9.588**	**9.430**	**9.711**	**9.759**	**10.206**	**10.119**	**10.672**	**11.265**	**11.367**	**11.476**	**11.594**
Expenditure from GF	Assumed range RMB2-2.5bn	7.759	2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.500	2.500	2.500	2.500	2.500
Principal Payments on Special Debt	Link to Principal Paym.	3.618	3.525	3.525	3.525	3.525	3.525	3.500	3.500	3.500	4.500	4.500	5.000	5.000
Transfers to PFB and Other Funds	Ensures PFB balance	2.551	3.402	3.630	3.773	3.631	3.897	4.292	4.150	4.638	4.226	3.680	3.645	3.133
Buyback Special Bonds	Ensures GFB balance	0.000	0.257	0.084	0.000	0.206	0.000	0.202	0.422	0.000	0.000	0.642	0.279	0.902
ADB-XT Project: Expenditure	Linked to Gross Borrowing			0.350	0.132	0.350	0.328	0.201	0.034					
ADB-XT Project: Principal Paym.on ADB Loan	Link to Principal Paym.						0.009	0.011	0.013	0.034	0.039	0.045	0.051	0.059
MEMO														
PFB Deficit = Expenditure MINUS Revenue (excl.Transfer from GFB)		2.638	3.402	3.630	3.874	3.631	3.956	4.292	4.150	4.825	4.238	3.680	3.645	3.133
GFB Surplus = Revenue MINUS Expenditure (excl.Transfer to PFB)		2.551	3.402	3.630	3.773	3.631	3.897	4.292	4.150	4.638	4.226	3.680	3.645	3.133

Table 6. Fiscal and Debt Prospects for Xiangtan Government – Project Scenario (cont.)

		Historical	Estimate	Forecast --->										
Billion RMB	**Assumptions**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Debt, Borrowings, and Debt Service														
Debt (stock)		**26.203**	**26.696**	**27.712**	**28.594**	**30.988**	**33.557**	**36.320**	**39.194**	**42.660**	**46.621**	**50.935**	**55.604**	**60.643**
General Debt	Δ Deuda = Net Borrowing	8.581	9.355	10.129	10.903	12.177	13.452	14.726	16.500	18.000	20.500	24.000	28.000	33.000
Special Debt	Δ Deuda = Net Borr. - Buyback	17.623	17.341	17.233	17.208	17.978	18.954	20.252	21.330	23.330	24.830	25.689	26.409	26.508
ADB Loan - Investment Financing	Δ Deuda = Net Borrowing			0.000	0.132	0.483	0.811	1.012	1.047	1.028	1.008	0.986	0.961	0.934
ADB Loan - Budget Support	Δ Deuda = Net Borrowing			0.350	0.350	0.350	0.341	0.330	0.317	0.302	0.283	0.261	0.234	0.202
Gross Borrowing (flow)		**7.872**	**5.500**	**5.850**	**5.632**	**7.350**	**7.328**	**7.701**	**8.034**	**9.000**	**10.500**	**11.500**	**12.500**	**13.500**
General Debt	Assumed range RMB2-7bn	2.251	2.000	2.000	2.000	2.500	2.500	2.500	3.000	3.500	4.500	5.500	6.500	7.500
Special Debt	Assumed range RMB5-7bn	5.621	3.500	3.500	3.500	4.500	4.500	5.000	5.000	5.500	6.000	6.000	6.000	6.000
ADB Loan - Investment Financing	Disbursement US$150mn in 3yrs				0.132	0.350	0.328	0.201	0.034					
ADB Loan - Budget Support	Disbursement US$50mn			0.350										
Principal Payments (flow)		**1.548**	**4.750**	**4.750**	**4.750**	**4.750**	**4.759**	**4.737**	**4.739**	**5.534**	**6.539**	**6.545**	**7.551**	**7.559**
General Debt	Debt with 7-yr maturity	0.546	1.226	1.226	1.226	1.226	1.226	1.226	1.226	2.000	2.000	2.000	2.500	2.500
Special Debt	Debt with 5-yr maturity	1.002	3.525	3.525	3.525	3.525	3.525	3.500	3.500	3.500	4.500	4.500	5.000	5.000
ADB Loan - Investment Financing	Loan with 25yr maturity & 5yr grace									0.018	0.020	0.022	0.024	0.027
ADB Loan - Budget Support	Loan with 15yr maturity & 3yr grace						0.009	0.011	0.013	0.016	0.019	0.022	0.027	0.032
Interest Payments (flow)		**0.795**	**1.048**	**1.068**	**1.094**	**1.124**	**1.214**	**1.303**	**1.406**	**1.542**	**1.681**	**1.840**	**2.014**	**2.202**
General Debt	Debt with 4% interest rate	0.275	0.343	0.374	0.405	0.436	0.487	0.538	0.589	0.660	0.720	0.820	0.960	1.120
Special Debt	Debt with 4% interest rate	0.520	0.705	0.694	0.689	0.688	0.719	0.758	0.810	0.853	0.933	0.993	1.028	1.056
ADB Loan - Investment Financing	Debt with 3% interest rate									0.022	0.022	0.021	0.021	0.020
ADB Loan - Budget Support	Debt with 3% interest rate						0.007	0.007	0.007	0.007	0.006	0.006	0.005	0.005
Net Borrowing (flow)		**6.323**	**0.750**	**1.100**	**0.882**	**2.600**	**2.569**	**2.965**	**3.296**	**3.466**	**3.961**	**4.955**	**4.949**	**5.941**
General Debt	Gross Borrowing minus Princ.Paym.	1.704	0.774	0.774	0.774	1.274	1.274	1.274	1.774	1.500	2.500	3.500	4.000	5.000
Special Debt	Gross Borrowing minus Princ.Paym.	4.619	-0.024	-0.024	-0.024	0.976	0.976	1.500	1.500	2.000	1.500	1.500	1.000	1.000
ADB Loan - Investment Financing	Gross Borrowing minus Princ.Paym.			0.000	0.132	0.350	0.328	0.201	0.034	-0.018	-0.020	-0.022	-0.024	-0.027
ADB Loan - Budget Support	Gross Borrowing minus Princ.Paym.			0.350	0.000	0.000	-0.009	-0.011	-0.013	-0.016	-0.019	-0.022	-0.027	-0.032
Debt and Debt Service Indicators														
Debt Stock as % of Revenue (*)		142	161	160	157	172	177	182	186	192	198	205	212	218
Debt Service as % of Revenue (*)		13	35	34	32	33	31	30	29	32	35	34	36	35
Debt Stock as % of Revenue (excl. land-related rev.) (**)		241	231	225	217	221	224	227	229	234	239	244	249	254
Debt Service as % of Revenue (excl. land-related rev.) (**)		22	50	47	44	42	40	38	36	39	42	40	43	41

Notes:

(*) Revenue includes: Tax Revenue, Non-Tax Revenue, Transfers from Upper-Level Gov't, and Land Use-Right Leasing Revenues

(**) Revenue includes: Tax Revenue, Non-Tax Revenue, and Transfers from Upper-Level Gov't